IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

WRS, INC., d/b/a WRS MOTION PICTURE LABRATORIES, a corporation, Plaintiff, v. PLAZA ENTERTAINMENT, INC., a corporation, ERIC PARKINSON, an individual, CHARLES BERNUTH, an individual, and JOHN HERKLOTZ, an individual, Defendants.	: : : : : : : : : : : : : : :	CIVIL ACTION NO. 00-2041

DEFENDANT HERKLOTZ'S MOTION FOR SUMMARY JUDGMENT OR, ALTERNATIVELY, MOTION FOR PARTIAL SUMMARY JUDGMENT

Defendant, JOHN HERKLOTZ, by his attorneys, BURNS, WHITE & HICKTON, LLC, sets forth the following Motion for Summary Judgment or, alternatively, Motion for Partial Summary Judgment:

FACTS

I. Introduction

1. On October 22, 2003[1], Plaintiff WRS, Inc. ("WRS"), a videotape manufacturing and duplicating company, filed this action against Plaza Entertainment, Inc. for alleged breach of an agreement to pay WRS for the

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[1] The procedural history of this action is extensive. For purposes of this Motion, defendant Herklotz limits the recounting of procedural history to those pleadings and events relevant to summary judgment.

reproduction of videotapes. The claim against Defendant John Herklotz is stated as a breach of guaranty contract action based upon his alleged personal guaranty for the debt of Co-Defendant Plaza Entertainment, Inc. (“Plaza”).

2. Also named as Defendants are Plaza executives, Eric Parkinson (“Defendant Parkinson”) and Charles von Bernuth (“Defendant Bernuth”).

3. Defendant Herklotz filed an Answer and Affirmative Defenses to Plaintiff’s Complaint.

4. On November 15, 2005 and January 23, 2006, the deposition of WRS’s President and designated corporate representative, Jack Napor, was taken, and discovery in this matter is now closed.

5. There are no genuine issues of material fact that remain to be decided by a fact finder as to the discharge of Defendant Herklotz’s alleged personal guaranty for the obligations of Plaza to WRS or WRS’s failure to reasonably prove damages.

II. The Breach of Contract Claims

6. In 1996, Defendant Eric Parkinson formed Plaza Entertainment, Inc., to engage in the commercial exploitation of various film and video titles through licenses, assignments or other transfer rights granted to it by the producers or other owners of the copyrights of various film and video titles. (Complaint, ¶ 9).

7. Parkinson obtained for Plaza the rights to duplicate, distribute and exploit a series of video titles (Complaint, ¶¶ 10 and 11).

8. Also in 1996, Plaza began a business relationship with WRS. (Napor Deposition, p. 73:9-16) (For the Court's convenience, the relevant excerpted pages of Jack Napor's deposition transcript are collectively attached to this Motion as Exhibit "A").

9. By April 1998, WRS had performed a significant amount of work for Plaza for which it had not been fully paid. (Napor Deposition, pp. 77-78, 79:10-25).

10. On or about April 29, 1998[2], Plaza submitted an order to WRS for dubs of a video entitled "Giant of Thunder Mountain." (WRS' Answers to Interrogatory Nos. 1 and 2; Napor Deposition, p. 76:17-25). Plaza requested that WRS perform the dubbing and fulfillment services on a credit basis.

11. WRS was allegedly unwilling to extend additional credit to Plaza unless Plaza paid its past due balance, updated its credit application, provided additional collateral, and executed a guaranty. (WRS Answer to Interrogatory No. 2; Deposition of Napor, pp. 81:8-25, 82:1-12).

12. On May, 6, 1998, Defendant Herklotz, provided his alleged personal guaranty of Plaza's debt to WRS to supply the duplication and fulfillment duties associated with the "Giant of Thunder Mountain" order on a credit basis. (Complaint, ¶ 17; Exhibit "B" of Complaint).

13. On July 24, 1998, Defendant Parkinson, acting as President and Chief Executive Officer of Plaza, submitted the updated account application required by WRS. (Complaint, ¶13). WRS alleges that it manufactured and delivered the videotapes to Plaza's customers. (Complaint, ¶ 14). However, according to Mr. Napor, WRS started duplicating tapes on Plaza's account at least as early as April 23, 1998, approximately 3 months before the application

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[2] It is believed that the original purchase order was dated April 24, 1998, but was not submitted to WRS until April 29, 1998. On April 30, 1998, the order was increased. (Napor Deposition, p.82:1-18).

completed by Mr. Parkinson on behalf of Plaza. (Napor Deposition, p. 90:21-25 and p. 91:1-2.

14. Plaza failed to pay an unverified outstanding balance, and as of August 31, 1998, WRS was carrying a significant receivable amount on Plaza’s account. (Complaint,¶¶ 19-20). However, discovery revealed that this amount contained charges dating back to at least January, 1997. (See Napor Deposition Exhibit 3, a WRS invoice to Plaza dated 3/31/97, attached hereto as Exhibit “B”).

15. By October 1998, WRS was allegedly concerned about Plaza’s failure to make payments for past due services. In order “to induce WRS to continue to provide duplication and fulfillment services to Plaza,” WRS required Plaza’s then-current executives, Defendants Parkinson and von Bernuth and Thomas Gehring, a third non-party principal, to enter into a “Services Agreement.” (Complaint, ¶ 21; Napor Deposition, pp. 121:10-25, 122, 123:2-8).

16. The Services Agreement, further discussed in this Motion, provided for a relinquishment of certain aspects of Plaza’s managerial control to WRS and additional security interests, conditions never contemplated by Defendant Herklotz’s May 6, 1998 guaranty. WRS has not established that Defendant Herklotz had any knowledge of this new agreement between WRS and Plaza that materially altered the risk Defendant Herklotz allegedly assumed by virtue of his guaranty.

17. Despite Plaza's failure to pay its obligations, WRS continued to provide duplication and fulfillment services to Plaza, as well as collection efforts on behalf of Plaza. (Napor Deposition, p. 152:8-23).

III. The October 12, 1998 Services Agreement

18. Defendants Parkinson and von Bernuth and Thomas Gehring, a third, non-party principal of Defendant Plaza, entered into a Services Agreement with WRS on October 12, 1998, after Plaza failed to pay its outstanding balance for manufacturing, dubbing and fulfillment services. Unlike the Account Application / Credit Application for which Defendant Herklotz provided the alleged personal guaranty, the Services Agreement provided for a fundamentally different relationship between WRS and Plaza.

19. Paragraph A of the Services Agreement provides:

> A. Plaza and WRS have an existing manufacturing and business relationship, and Plaza has immediate need for (i) working capital financing ("Financing") and (ii) certain administrative services, including, generation of sales invoices, collections of amounts receivables [sic], performance of general accounting and related record keeping functions, monitoring and maintenance of inventories of packaging, finished goods, returns processing and repackaging (collectively, the "Administrative Services").

20. By virtue of the Services Agreement, WRS became “Plaza’s exclusive agent” to perform the above-outlined duties, previously performed by Plaza itself, in addition to the production services WRS was already performing.

21. Moreover, Section 1 of the Services Agreement provided that Plaza would pay WRS’s out-of-pocket expenses for administrative services, plus a $5,000.00 monthly fee for services, including the maintenance of a “lock box” account.

22. WRS and Plaza’s documents, for which WRS was responsible pursuant to the Services Agreement, are missing, have not been produced, or were never created in the first instance. Examples include the following:

a. Plaza’s earliest purchase orders with WRS, detailing the quantities ordered, the titles duplicated and the Plaza customers to whom they were shipped, were not kept after production (Napor Deposition, pp. 66:12-25, 67:1-21);

b. Mr. Napor estimates that the volume of business that WRS performed for Plaza prior to the July 24, 1998 date cited in the Complaint was *approximately* $121,000, but *could have been* more. (Napor Deposition p. 74:8-22) [Emphasis added];

c. WRS has not produced or cannot produce any document indicating that an account receivable was owed to WRS by Plaza as of July 24, 1998, the date of the submission of the updated Account Application/ Credit Application upon which the instant lawsuit is premised. “[W]e can’t find what you’re asking for in July.” (Napor Deposition, pp. 77:16-25, 78:2-25);

d. WRS cannot ascertain whether Plaza’s account balance as of August 31, 1998, the date designated by the July 24, 1998 Account Application when Plaza was to fully pay its outstanding balance, was $685,379 as pleaded in the Complaint or $720, 679 as indicated on an August 31, 1998 Account Statement marked as Napor Deposition Exhibit No. 4 (attached to this Motion as Exhibit "C");

e. Explaining reasons why so many records are not provided or cannot be located, Mr. Napor stated, "Over the time, and we haven't been a fully functional business, … [S]omewhere along the line we have lost track of some paperwork because I remember it being much more voluminous that we have now, but I also don't think there was anything germane. I think we have all the important stuff here." (Napor Deposition, pp. 107:23-24, 108:4-10);

f. August 26, 2001 *Pittsburgh Post Gazette* interview of Jack Napor regarding WRS record keeping problems (attached to this Motion as Exhibit "D");

g. Mr. Napor, whose knowledge is imputed to WRS by virtue of his corporate designee status, stated that he had no understanding of the total amount of money that was deposited into a lock box account. (Napor Deposition, pp. 144:3-6, 198:7-25, 199:2-3);

h. When asked to produce all documents demonstrating that WRS billed Plaza during the seventeen (17) month period that WRS performed administrative services rendered pursuant to the Services Agreement, WRS states there were "none." See WRS's Response to Request No. 5 of Defendant Herklotz's Second Request for Production of Documents; and

i. Beginning in January 2000, problems with WRS's new computer software system resulted in frequent errors including: over billing and under billing clients and adding 0's unpredictably to either the quantity of products ordered or the unit prices, inflating the value of the invoices. (Napor Deposition, pp. 226:11-25, 227:2-13).

23. The Services Agreement, primarily through WRS's collection efforts and administering of a lock box as set forth in Sections 1 and 1.1 of the Services Agreement, was meant to facilitate payment of Plaza's debts to WRS and to keep better track of Plaza's records. (Napor Deposition, pp. 127:22-25, 128:1-10).

24. Instead, the Services Agreement compounded Plaza's debt to WRS, materially increasing Defendant Herklotz's risk, and caused WRS to further confuse record keeping such that Plaza's obligations to WRS cannot be reasonably calculated.

ARGUMENT

I. The October 12, 1998 Services Agreement Materially Modified the Creditor-Debtor Relationship, Substantially Increasing Herklotz's Risk, Thereby Discharging His Obligation.

27. Initially, the terms "suretyship" and "guaranty" must be defined and clarified. 8 P.S. § 1 states in full:

> Every written agreement hereafter made by one person to answer for the default of another shall subject such person to the liabilities of suretyship, and shall confer upon him the rights incident thereto, unless such agreement shall contain in substance the words: "This is not intended to be a contract of suretyship," or unless each portion of such agreement intended to modify the rights and liabilities of suretyship shall contain in substance the words: "This portion of the agreement is not intended to impose the liability of suretyship."

28. The May 6, 1998 document signed by Defendant Herklotz is properly a suretyship in that the document does not contain the above-referenced statutory language.

29. Further, WRS alleges that Defendant Herklotz executed a suretyship for Plaza's outstanding debt as an additional inducement to WRS to supply duplication and fulfillment services on a credit basis.

30. There is no allegation that Defendant Herklotz was compensated by Plaza or anyone else for executing the suretyship agreement at issue in this matter. Defendant Herklotz is therefore a " gratuitous surety".

31. Pennsylvania courts have consistently differentiated between gratuitous (uncompensated) sureties and compensated sureties. J.F. Walker Co., Inc. v. Excalibur Oil Corp., Inc., 792 A.2d 1269 (Pa. Super. 2002).

32. "Where, without the surety's consent, there has been a material modification in the creditor-debtor relationship, a gratuitous surety is completely discharged." Continental Bank v. Axler, 510 A.2d 726, 729 (Pa. Super. 1986).

33. A material modification in the creditor-debtor relationship consists of a significant change in the principal debtor's obligation to the creditor that in essence substitutes an agreement substantially different from the original agreement on which the surety accepted liability. Continental Bank, at 729.

34. Defendant Herklotz executed the suretyship agreement on May 6, 1998.

35. Defendant Herklotz's suretyship agreement did not waive increased risk of the surety, and in fact does not contain the words "increased risk".

36. Plaza allegedly defaulted sometime after Defendant Herklotz executed the suretyship document.

37. Without notice to Defendant Herklotz, WRS and Plaza principals entered into a "Services Agreement" on October 12, 1998 that materially changed the creditor-debtor relationship.

38. Pursuant to the Services Agreement, WRS agreed to perform management duties including, administering collection services, restocking services, generating sales invoices, monitoring and maintenance of bank accounts and a "lock box". Plaza relinquished control of its ability to recoup profits to pay its debts.

39. Also pursuant to the Services Agreement, Plaza was now charged a $5000/monthly fee and all of WRS's out-of-pocket expenses for administrative services that Plaza had previously handled itself.

40. The Services Agreement is a substantially different agreement than the original agreement between WRS and Plaza fundamentally changed the nature of the WRS-Plaza commercial relationship and in the process significantly increased Defendant Herklotz's risk.

41. Defendant Herklotz's suretyship agreement never contemplated that, without notice to him, Plaza's debts would be compounded by WRS's managerial control of Plaza and collection services on behalf of Plaza.

42. Defendant Herklotz has met the requirements for complete discharge of a gratuitous surety's obligation under Pennsylvania law, and as such, he is entitled to summary judgment.

43. In the event that this Court declines to fully discharge Defendant Herklotz's obligation, Defendant Herklotz respectfully requests the Court to limit his obligation to the amount owed by Plaza as of the date that Plaza first defaulted on its payments to WRS, if that date can be determined and the figure can be reasonably calculated on the basis of facts on the record, although Defendant Herklotz respectfully asserts that the date cannot be determined and the figure cannot be reasonably calculated.

II. ***WRS's Alleged Damages Cannot Be Reasonably Calculated***

44. WRS' proof of damages is muddled and confused due to poor record keeping, failure to produce documentation, or inability to produce documentation because records were never maintained in the first instance.

45. WRS' damages cannot be reasonably calculated.

46. The Plaintiff in an action for breach of contract has the burden of proving damages resulting from the breach. Spang v. U. S. Steel Corporation, 545 A.2d 861 (Pa. 1988).

47. Further, as a general rule, damages are not recoverable if they are too speculative, vague or contingent and are not recoverable for loss beyond an amount that the evidence permits to be established with reasonable certainty. *Restatement (Second) of Contracts*, § 352; *Murray on Contracts*, § 226.

48. WRS cannot demonstrate the amounts owed by Plaza and when; an occasional invoice is not enough.

49. WRS has produced no report prepared by an accountant or forensic accountant who might provide an accurate determination of damages.

50. WRS must come forward with an organized, documented and reasonable calculation of damages. WRS has failed to do so. As such, WRS cannot prove a material element of a breach of contract action.

WHEREFORE, for all of the foregoing reasons, Defendant Herklotz, respectfully requests that this Honorable Court sign the attached Order granting summary judgment in his favor on all counts against him as a matter of Pennsylvania law.

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the within **Motion for Summary Judgment or, Alternatively, Motion for Partial Summary Judgment** has been served on counsel listed below by electronic mail on this 24th day of February, 2006:

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